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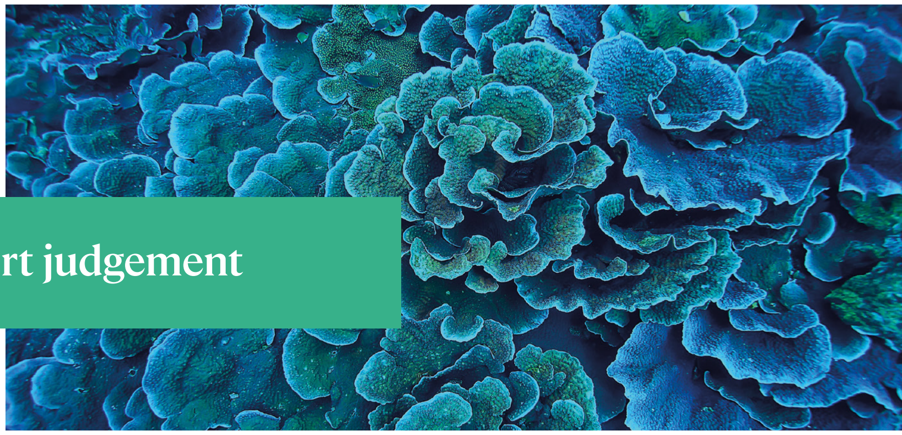

Charity court judgement

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Climate-related screening of investments gets continued 'green light' in new court ruling

The High Court in England and Wales has confirmed that climate-related screening of investments can be a valid approach for charity trustees, in a case brought by trustees of two large grant-making trusts.

In a decision acknowledged as "momentous" by the judge, the court granted a declaration that the trustees of two of the Sainsbury Family Charitable Trusts are permitted to adopt a new investment policy statement (IPS) with various climate and environment-related screens and, importantly, that doing so is a proper exercise of their powers of investment in line with their trustee duties.

The quality of trustee deliberations matters

While much in the case is particular to the two charities (e.g. the two charities had environmental protection among their charitable purposes), Mr Justice Michael Green does deliver a ten point analysis in paragraph 78 of the judgement, which will be of particular use to charities whose underlying legal form is that of a trust. In short, the judgement offers reassurance that the kind of decision making approach of many boards in recent years is exactly the kind of deliberative balancing-act by trustees that the law should enable and protect. It's reminiscent of the proverbial maths test, where the workings matter as much as the answer. Indeed, point ten of the analysis says: "If that balancing exercise is properly done and a reasonable and proportionate investment policy is thereby adopted, the trustees have complied with their legal duties in such respect and cannot be criticised, even if the court or other trustees might have come to a different conclusion."

The goal of 'maximising returns' is tempered by other considerations

It's been 30 years since the Bishop of Oxford case, the last important judgement on trustee decision-making on charity investments. Taken in isolation, comments by the judge in that case have taken on more prominence over the years than perhaps they should have, creating the mistaken impression that the sole investment goal of a charity trustee in England and Wales is to maximise investment returns. Helpfully, this new case provides clarification, politely noting that this oft-repeated mantra of maximisation "is not necessarily the end point". As the ten point analysis illustrates, trustees do have discretion to exclude investments in certain situations. The balancing act needs to take into account whether certain investments could potentially conflict with a charity's purposes, and the likelihood and seriousness of any potential financial effect of exclusions. In considering the financial effect of exclusions, reputational damage to the charity or loss of donor support are also relevant factors.

Starting the journey to alignment with the Paris Climate Agreement

The case shines a spotlight on the emerging art and science of "Paris-aligned investing". The details of the proposed IPS (similar for each charity) focused on filtering investments based on alignment to the goals of the Paris Climate Agreement. The IPS had a number of quantitative screens in terms of greenhouse gas (GHG) emission reductions over certain timelines. Qualitative screens focused on screening out energy intensive companies (e.g. cement, steel, paper and mining) unless the companies have adopted a plan that accords with the Paris Agreement. Beyond the "Paris-aligned" approach, the IPS also covered familiar territory in terms of tobacco and armaments screens.

The trusts' investment managers reported that they could invest the portfolios in line with the proposed IPS, noting that the IPS would exclude approximately 20.1% of the investible universe. It was expected that the investment universe could reduce further in future, as the measurability of scope 3 GHG emissions becomes more accurate over time. As such, it was interesting to note that the exact financial impact of applying the screens was unknown (and unknowable) at the current time. Estimates were, however, sufficient.

A point to take from this is the importance of partnership and dialogue between a charity and its investment manager, as an input to trustee decision-making. Investment managers can assist trustees in understanding the potential consequences of applying certain exclusions to their portfolio, in terms of the impact to the size of the investible universe from which returns can be sought.

Charities are not obliged to favour engagement over divestment

In an interesting point of detail in the arguments, the QC representing the Charity Commission for England and Wales (the defendants in the case) submitted that there was "no evidence of the [trustees] considering alternative strategies such as engaging with companies as a shareholder to bring about change from within rather than divesting completely." The judge concluded "But I think this criticism is unfounded. The [charity trustees] have decided, reasonably in my view, that there needs to be a dramatic shift in investment policies in order to have any appreciable effect on greenhouse gas emissions and for there to be any chance of ensuring that there is no more than a 1.5°C rise in pre-industrial temperature." This passage will be of interest to those following the 'engagement v divestment' debate, including many universities, endowments and foundations.

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>
> Julie Hutchison, Technical Director - Charities

Your investment policy statement has never been more important

The outcome of the case is a reminder that good governance with charity investments starts with having a well-considered, thought through and current IPS. In this case, the two charities had an IPS dating from 2015, together with a proposed new IPS in 2020. This illustrates the point perfectly, that things change over time, even in just a few years. If your charity created its IPS more than five years ago, it may be time to revisit it – decisions made five years ago may look different in today's light.

OSCR guidance in Scotland already includes case studies on environmental themes

This case in England and Wales creates no particular consequences for trustees of Scottish charities. The OSCR guidance on charity investments already includes commentary on "what else should you think about before investing", including thinking about how to align your investments to your charity's purposes. Arguably, this new case brings the position in England and Wales closer to Scotland, with the focus on the quality and nature of trustee deliberations in the round, which avoids a prescriptive approach and enables trustees to take a broad range of considerations into account.

The new CC14 reflects this court case

In summer 2023, the Charity Commission of England and Wales published its updated investment guidance, known as CC14. It largely reflects the court case and its emphasis on the quality of trustee deliberations. Trustees will want to review their investment policy statement against the backdrop of both this court case and the new CC14 guidance. Our article with an overview of CC14 can be found **here**.

For more information, please contact Julie Hutchison, Technical Director - Charities on **julie.hutchison@lgt.com**.

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